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Mandatory Recording of Personal Property Leases in South Carolina: An Examination of the South Carolina Bailment Statute as Affected by U.C.C. Article Nine

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NOTES

MANDATORY RECORDING OF PERSONAL PROPERTY LEASES IN SOUTH CAROLINA: AN EXAMINATION OF THE SOUTH CAROLINA BAILMENT STATUTE AS AFFECTED BY U.C.C. ARTICLE NINE

INTRODUCTION

Over the past two decades the lease has dramatically expanded into a major commercial transaction within the United States. Inflation, recession, high interest rates, and rapidly advancing technologies are causing record numbers of potential buyers to turn to leasing as an alternative to purchasing personal property. Five years ago, estimates placed the value of leased goods at over ten billion dollars with the following proportions of new equipment being leased: 70% of all computers, 30% of all passenger cars, 60% of all office equipment, 50% of all railroad cars, 25% of all aircraft, 15% of all ships, and 10% of all machinery and furniture and fixtures.[1] Since that time, the leasing industry has grown to an estimated one hundred billion dollars and continues to grow at a rate of 10% to 12% ever year.[2]

While the lease has been a boon to the lessee, it has created certain problems for the lessee's creditors and those who purchase from the lessee. The lease passes only the right to use the property; no ownership rights are acquired by the lessee. Yet, while in possession of the property, the lessee has apparent ownership of the property that can easily mislead a creditor into relying on that property for security, or induce an innocent purchaser to buy that property. In response to situations in which the apparent ownership of property by a person who merely holds a possessory interest can mislead third parties, a theory of ostensible or re-

1. Coogan, *Leases of Equipment and Some Other Unconventional Security Devices: An Analysis of UCC Section 1-201(37) and Article 9*, 1973 DUKE L.J. 909, 912 n.4 (citing VALUE LINE INVESTMENT SURVEY, Oct. 12, 1973 at 227 and BUS. WEEK, Sept. 4, 1971 at 42).

2. Colasanti, *Considering Capital Leasing When Making the "Big" Buy*, 15 DATA MANAGEMENT 32, 36 (May 1977). For additional statistics on the size of the leasing industry, see Wajnert, *Leasing Gains Edge for Many Big Buys*, 80 PURCHASING 79 (March 30, 1976); Romans, *Why Leasing Is Becoming So Popular*, 63 NATION'S BUSINESS 74 (June 1975).

puted ownership has evolved that renders this property subject to the debts of the ostensible owner.

This doctrine of ostensible ownership had its beginnings in the English Bankruptcy Act, as amended in 1623,[3] which provided that if a person became bankrupt, any property not owned by him but left in his possession by the true owner would be included as part of the bankrupt's estate in settling the accounts of his creditors. The true owner was barred from asserting his title in seeking to reclaim his property.[4] While not completely emulating their English counterparts, the bankruptcy statutes of the United States achieve a comparable result through the voidable preference powers.[5] These provisions endow the trustee in bankruptcy with all of the rights and powers of a creditor who has acquired a judicial lien as of the time of initiation of the bankruptcy proceedings. Through the doctrine of estoppel, which arises out of a presumption that creditors relied on the debtor's ostensible ownership,[6] the lien-creditor status permits the trustee to avoid hidden ownership inerests. South Carolina courts have recognized that creditors "are legally presumed to give credit on the faith of the property in their debtor's possession."[7]

In response to this estoppel doctrine, which is based on the reputed ownership of the debtor in possession, recording statutes have been widely adopted within the United States. Founded on the theory that the record rebuts the potentially fraudulent misrepresentation created by apparent ownership, these statutes enable the true owner to protect his interest in the property by

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3. If at any time hereafter any person or persons shall become bankrupt, and at such time as they shall so become bankrupt shall by the consent and permission of the true owner and proprietary have in their possession, order and disposition, any goods or chattels, whereof they shall be reputed owners, and take upon them the sale, alteration or disposition as owners, that in every such case the said commissioners or the greater part of them shall have power to sell and dispose the same, to and for the benefit of the creditors which shall seek relief by the said commission, as fully as any other part of the estate of the bankrupt.

21 Jac. I, c. 19, § 11 (1623) *reprinted in* 1. G. GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 342 (rev. ed. 1940).

4. 1 G. GLENN, *supra* note 3, at § 342.

5. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2596 (1978) (to be codified at 11 U.S.C. § 544). This Act takes effect on Oct. 1, 1979; this section will replace the present § 70(c)(3) of the Bankruptcy Act at 11 U.S.C. § 110.

6. 1 G. GLENN, *supra* note 3 at § 343, p. 596. *See also* Casey v. Cavorac, 96 U.S. 467, 490 (1877) ("if the debtor remains in possession, the law presumes that those who deal with him do so on the faith of his being the unqualified owner of the goods."); Robinson v. Elliott, 89 U.S. (22 Wall.) 513 (1873) ("men get credit for what they apparently own and possess . . . .").

7. Brock v. Bowman, 9 S.C. Eq. (1 Rich. Eq.) 185 (1832).

providing the potential creditor or purchaser with notice of the true status of the property in question.[8]

The South Carolina Code of Laws contains two recording statutes affecting leases, section 30-7-10 and section 27-23-80. Section 30-7-10 requires in part that all deeds of real property, all leases of real property with a duration of over one year, and all mortgages of both real and personal property must be recorded in the office of the register of mesne conveyances or clerk of court or in the office of the Secretary of State.[9] Section 27-23-80, the bailment statute, applies to any agreement between the vendor and the vendee or the bailor and bailee of personal property by which the vendor or bailor reserves an interest in the property. These agreements must be recorded in the manner prescribed for the recording of mortgages.[10]

The most significant aspect of the bailment statute is that true leases of personal property are included within its scope.[11] It is the intent of this note to explore the application of the bailment statute to true leases in South Carolina, study the effects of the Uniform Commercial Code (UCC) on this statute, and evaluate certain proposed alternatives to the current recording requirements.

I. South Carolina's Bailment Statute

The South Carolina bailment statute reads as follows:

> Every agreement between the vendor and vendee or the bailor and bailee of personal property whereby the vendor or bailor shall reserve to himself any interest in the property shall be null and void as to subsequent creditors (whether lien creditors or simple contract creditors) or purchasers for a valuable consideration without notice unless such agreement be reduced to writing and recorded in the manner provided by law for the recording of mortgages. In the case of a subsequent mortgage of the property for valuable consideration without notice, the instrument evidencing such subseqent mortgage must be filed for record in order for its holder to claim under this section as a subsequent mortgagee for value without notice and the priority shall be determined by the time of filing for record. But nothing

8. Hanna, *The Extension of Public Recordation,* 31 Col. L. Rev. 617, 622-23 (1931).
9. S.C. Code Ann. § 30-7-10 (1976).
10. *Id.* § 27-23-80.
11. Ludden & Bates Southern Music House v. Dusenberry, 27 S.C. 464, 4 S.E. 60 (1887).

> herein contained shall apply to livery stable keepers, inkeepers or other persons letting or hiring property for temporary use or for agricultural purposes or depositing such property for the purpose of repairs or work or labor done thereon or as a pledge or collateral to a loan.[12]

The South Carolina bailment statute has a long legislative history that dates back to 1843.[13] The underlying purpose of the statute is to prevent the apparent ownership of the person in possession of personal property from misleading his bona fide creditors or purchasers. Its main thrust is to prevent the secret lien and estop the true owner, whether a vendor or bailor, from setting up his title in derogation of the rights of the deceived creditor or purchaser.[14] Viewing this statute in light of its companion mortgage recordation statute[15] prompted one court to declare that "[i]t would be difficult to frame a statute expressing more clearly and broadly than the South Carolina statutes express the intention to sweep away all secret liens, and claims set up under them against subsequent creditors."[16] Accordingly, the courts have faithfully followed the statute's mandate that "[e]very agreement . . . whereby the vendor or bailor shall reserve to himself any interest in the property" must be recorded or declared null and void for subsequent creditors or purchasers for value without notice.[17] Subsequent creditors and purchasers have avoided unrecorded chattel mortgages[18] and conditional sales contracts[19] because of the bailment statute. Most importantly, however, unrecorded "bailments" have also fallen prey to the statute's requirements.[20]

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12. S.C. CODE ANN. § 27-23-80 (1976) [hereinafter cited as the bailment statute]. *See, e.g.*, Carrol v. Cash Mills, 125 S.C. 332, 346, 118 S.E. 290, 294 (1923) ("commonly referred to as the Bailment Act").

13. For legislative history and annotations, see S.C. CODE ANN. § 27-23-80 (1976).

14. Andrews v. Hurst, 163 S.C. 86, 92, 161 S.E. 331, 334 (1931); Carroll v. Cash Mills, 125 S.C. 332, 348-49, 118 S.E. 290, 295 (1923).

15. S.C. CODE ANN. § 30-7-10 (1976) and text accompanying note 9 *supra*.

16. Industrial Finance Corp. v. Cappleman, 284 F. 8, 11 (4th Cir. 1922).

17. S.C. CODE ANN. § 27-23-80 (1976).

18. Tyson v. National Discount Corp., 149 F. Supp. 592 (E.D.S.C. 1957); Wardlaw v. Troy Oil Mill, 74 S.C. 368, 54 S.E. 658 (1906).

19. Townsend v. Ashepoo Fertilizer Co., 212 F. 97 (4th Cir. 1914); Tyson v. National Discount Corp., 149 F. Supp. 592 (E.D.S.C. 1957); *In re* M.L.B. Sturkey Co., Inc., 224 F. 251 (W.D.S.C. 1915); Armour & Co. v. Ross, 75 S.C. 201, 55 S.E. 315 (1906).

20. Industrial Finance Corp. v. Cappleman, 284 F. 8 (4th Cir. 1922); Townsend v. Ashepoo Fertilizer Co., 212 F. 97 (4th Cir. 1914); *In re* Smith, 48 F. Supp. 866 (E.D.S.C. 1943); *In re* Tansill, 17 F.2d 413 (W.D.S.C. 1922); Stephens v. Hndricks, 228 S.C. 458, 90 S.E.2d 632 (1955); Andrews v. Hurst, 163 S.C. 86, 161 S.E. 331 (1931).

Since "a bailment is a delivery of a thing in trust for some special object or purpose, and upon a contract, express or implied, to conform to the object or purpose of the trust,"[21] the term "bailment" contains within its scope "a hiring of a thing for use," which is merely a bailment for a reward or compensation.[22] Therefore, a lease of personal property in South Carolina is directly within the purview of the bailment statute as an agreement between a bailor and a bailee. If unrecorded, a lease will be declared null and void as against subsequent creditors or purchasers.[23]

A party who invokes the application of the bailment statute to a particular agreement must qualify within one of the three expressly protected groups: lien creditors, simple contract creditors, or purchasers for a valuable consideration.[24] Within these protected groups the courts have included trustees in bankruptcy,[25] the State when enforcing tax liens,[26] landlords,[27] and even lessees of real property.[28] Further statutory analysis reveals that all of these protected creditors or purchasers must be subsequent to and without notice of the agreement in question.[29] Whether the creditor is required to have actually relied on the ostensible ownership is a matter upon which the courts have vacillated.[30]

This conflict arises from seemingly inconsistent holdings by the South Carolina Supreme Court. Early in the history of the

21. J. STORY, COMMENTARIES ON THE LAW OF BAILMENTS, 4 (5th ed. 1851).

22. *Id.* at 10-11.

23. Ludden & Bates Southern Music House v. Dusenberry, 27 S.C. 464, 4 S.E. 60 (1887).

24. S.C. CODE ANN. § 27-23-80 (1976).

25. Tyson v. National Discount Corp., 149 F. Supp. 592 (E.D.S.C. 1957); *In re* Smith, 48 F. Supp. 866 (E.D.S.C. 1943); *In re* Tansill, 17 F.2d 413 (W.D.S.C. 1922); *In re* M.L.B. Sturkey Co., Inc., 224 F. 251 (W.D.S.C. 1915); Townsend v. Ashepoo Fertilizer Co., 212 F. 97 (4th Cir. 1914).

26. Stephens v. Hendricks, 228 S.C. 458, 90 S.E.2d 632 (1955); Andrews v. Hurst, 163 S.C. 86, 161 S.E. 331 (1931).

27. Fidelity Trust & Mortgage Co. v. Davis, 158 S.C. 400, 155 S.E. 622 (1930) (the court observed, however, that a landlord may only distrain if the tenant owned the property in his own right, which was a question for the jury).

28. Ruff v. Columbia Railway, Gas and Electric Co., 109 S.C. 312, 96 S.E. 183 (1918) (this court declared that a lease for a term of years is sufficient to qualify as a purchase for the purpose of the bailment statute).

29. *See id. See also In re* Tansill, 17 F.2d 413, 416-17 (W.D.S.C. 1922) (analysis of the requirement that creditors or purchasers be subsequent); Stephens v. Hendricks, 228 S.C. 458, 461, 90 S.E.2d 632, 633 (1955).

30. Means, *The Recording of Land Titles in South Carolina (Herein of Bona Fide Purchase of Land): A Title Examiner's Guide,* 10 S.C.L.Q. 346, 380 nn. 146 & 147 (1958) (and accompanying text).

bailment statute, the court declared in *Wardlaw v. Troy Oil Mill*[31] that reliance was not a necessary element in defeating an unrecorded agreement.[32] The only requirements are that the creditor be a subsequent creditor without notice of the agreement.[33] In two later cases, however, the court stated that a creditor must have relied on the apparent possession or ownership of the debtor.[34] An examination of the facts of these two cases reveals that the creditor's claim arose prior to the debtor's receipt of the goods. Although couching its opinion in terms of reliance, the court was apparently concerned with whether the creditor's interest arose after the bailment. Admittedly, the court used the terms "creditors, who have relied"[35]; however, the theory seems to rest on the requirement of being "subsequent." In a more recent decision,[36] the court reverted to the requirements of *Wardlaw* and held that a landlord, as a subsequent creditor, could avoid any unrecorded agreement "even though credit was not extended on the faith of the property in question."[37] This history, coupled with the court decisions allowing trustees in bankruptcy and the State (neither of which rely on any property when the hypothetical credit is extended) to avoid unrecorded agreements,[38] fully indicates that reliance on the property is not a requisite to invoking the bailment statute. Rather, as stated in *Wardlaw*:

> [p]roof that a subsequent creditor did not even know of the existence of the property covered by an unrecorded mortgage would not avail the mortgagee, for the reason that the statute makes no such exception in the protection afforded to subsequent creditors without notice. Secret liens ought not to be favored, and we are not inclined to indulge in any attempts at refinement in the interpretation of the statute in order to protect those who from their design or negligence fail to record their

31. 74 S.C. 368, 54 S.E. 658 (1906).

32. *Id.* at 372-73, 54 S.E. at 659-60.

33. S.C. CODE ANN. § 27-23-80 (1976).

34. Finance Corp. of America v. McGhee, 142 S.C. 380, 140 S.E. 691 (1927); Carroll v. Cash Mills, 125 S.C. 332, 118 S.E. 290 (1923).

35. Carroll v. Cash Mills, 125 S.C. 332, 341, 118 S.E. 290, 292 (1923).

36. Fidelity Trust & Mfg. Co. v. Davis, 158 S.C. 400, 155 S.E. 622 (1930).

37. *Id.* at 409, 155 S.E. at 626.

38. For cases concerning a trustee in bankruptcy, see Townsend v. Ashepoo Fertilizer Co., 212 F.2d 97 (4th Cir. 1914); Tyson v. National Discount Corp., 149 F. Supp. 592 (E.D.S.C. 1957); *In re* Smith, 48 F. Supp. 866 (E.D.S.C. 1943); *In re* Tansill, 17 F.2d 413 (W.D.S.C. 1922); *In re* M.L.B. Sturkey Co., Inc., 224 F. 251 (W.D.S.C. 1915). For cases concerning the state as a tax-lien creditor, see Stephens v. Hendricks, 228 S.C. 458, 90 S.E.2d 632 (1955); Andrews v. Hurst, 163 S.C. 86, 161 S.E. 331 (1931).

papers and then when disaster comes set them up against subsequent unsecured creditors.[39]

To complete the examination of the scope of the bailment statute, it is necessary to investigate the exceptions to its requirements. Of those enumerated in the last sentence of the statute, the exceptions covering livery stable keepers, inkeepers, hiring for agricultural purposes and depositing for repair, work, or as a pledge or collateral for a loan are all self-explanatory and no litigation of consequence has evolved out of them. The lone exception that has caused problems and is important to any study of true leases in South Carolina is that which exempts "persons letting or hiring property for temporary use."[40]

Inherent in any personal property leasing situation is the determination of whether the nature of the lease requires recording. If the arrangement is merely for the temporary use of the property it is not subject to the bailment statute. The few cases in which the phrase "temporary use" was considered present only a rough approximation of the meaning of the term. It has been held that a nine-month lease of an organ was nontemporary in nature and thus within the recordation mandates of the bailment statute.[41] In later decisions, however, it was held that the consignment of cloth as samples[42] and the renting of a car for ten dollars per week for an indefinite duration[43] were temporary uses exempt from filing. The best analysis of the term "temporary use" came in *Gulf Refining Co. v. McCanless,*[44] in which the South Carolina Supreme Court was faced with a one dollar annual rental agreement covering gas storage tanks and lines. The court observed that:

> [i]n order properly to construe the words "nothing herein contained shall apply to any persons renting or hiring property for temporary use," it is necessary for us to ascertain the intention of the statute. Its primary purpose, unquestionably, was the protection of subsequent creditors and purchasers for valuable consideration without notice. Therefore the word "temporary" was not used in contradistinction to the word "permanent," for

39. Wardlaw v. Troy Oil Mill, 74 S.C. 368, 372-73, 54 S.E. 658, 660 (1906).
40. S.C. CODE ANN. § 27-23-80 (1976).
41. Ludden & Bates Southern Music House v. Dusenberry, 27 S.C. 464, 4 S.E. 60 (1887).
42. *In re* Nachman, 212 F. 460 (E.D.S.C. 1914).
43. Dodd v. Edwards, 172 S.C. 213, 173 S.E. 633 (1934).
44. 118 S.C. 6, 109 S.E. 801 (1921).

> any definite period of time, but to indicate such length of time as is not reasonably calculated to mislead subsequent creditors and purchasers into the belief that the person in possession of the property is the owner thereof.[45]

Although this interpretation does not set out a clear and easily applied length-of-time test, it adequately reflects the spirit of the bailment statute. Certainly any lessor who believes that his lease might traverse the line from "temporary" into "misleading" would be wise to record that lease.[46] It would be appropriate, nevertheless, to establish a more definite test to determine whether a proposed lease is temporary. For example, a temporary lease could be defined as any lease for a period less than one year. This period of time has already been applied to loans of real estate to require such leases for a period of twelve months or more to be recorded.[47]

II. THE EFFECT OF THE ADOPTION OF THE UNIFORM COMMERCIAL CODE[48]

The enactment of the UCC into law by forty-nine states, the District of Columbia, and the Virgin Islands,[49] accomplished a major overhaul and unification of commercial law in this country. In South Carolina the adoption of the UCC, particularly Article 9, has had a major impact on the bailment statute.

The scope of Article 9 is set out in section 9-102 which establishes in pertinent part that

> [T]his Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state
>
> (a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights;
>
> . . . .

45. *Id.* at 9, 109 S.E. at 802.

46. The dichotomy established by such a test is best illustrated by way of example. As noted in Dodd v. Edwards, 172 S.C. 213, 173 S.E. 633 (1934), a daily car rental for an indefinite duration is exempt from recording; however, a multiple-year car lease through a financing institution or a car dealer would probably not be exempt. Likewise, hourly, daily, or even weekly rental of equipment, such as from a rental shop, would be exempt, but equipment leased for a year or more (or even close to a year as in Ludden & Bates Southern Music House v. Dusenberry, 27 S.C. 464, 4 S.E. 60 (1887)) would probably not be exempt.

47. S.C. CODE ANN. § 30-7-10 (1976).

48. All references to the Uniform Commercial Code [hereinafter cited as UCC] will be to the 1962 official text unless indicated otherwise.

49. J. WHITE & P. SUMMERS, HANDBOOK ON THE UNIFORM COMMERCIAL CODE 1 (1972).

The result of the passage of Article 9 into law is that a single form of security interest is substituted for the plethora of devices that existed prior to the UCC — for example, the pledge, the chattel mortgage, and the conditional sales contract. To enhance the comprehensive posture of the UCC and to further its avowed intent to unify commercial law, South Carolina, when adopting the UCC, included a general repealer section, which provides that "[a]ll acts and parts of acts inconsistent with this act are hereby repealed."[50] Thus, when Article 9 of the UCC went into force in this state on January 1, 1968,[51] a serious blow was dealt to the scope of the bailment statute.

Prior to the adoption of the UCC, personal property mortgages were recorded in the office of the register of mesne conveyances (R.M.C. Office) in the county where the owner of the property resided if he resided within the state; but if he resided outside the state it was recorded in the county where the property was located. If there was no R.M.C. Office, then the chattel mortgages were recorded in the office of the clerk of court of the appropriate county or in the office of the Secretary of State.[52] The bailment statute required that any agreement between vendor and vendee or bailor and bailee be recorded in the same manner as provided by law for mortgages.[53]

Under the UCC creditors protect their rights in collateral by perfecting their security interests. Perfection establishes the order of priority of the various claims against the property.[54] The vehicle for perfecting a security interest, with a few exceptions,[55] is the filing of a UCC financing statement in the appropriate office.[56] In keeping with the preemptory nature of the UCC in all situations incorporated within its scope, the bailment statute is superseded by Article 9, whenever the bailment statute conflicts with the application of Article 9 to security interests. A threshold inquiry must be made, therefore, to determine what sorts of agreements qualify as Article 9 security interests.

While section 9-102(1)(a) establishes that any transaction intended to create a security interest is within the scope of Article

50. S.C. CODE ANN. § 36-10-103 (1976).
51. *Id.* § 36-10-101.
52. *Id.* § 30-7-10.
53. *Id.* § 27-23-80.
54. *See, e.g., id.* §§ 36-9-301 through -306, 36-9-312 and 36-9-313. (The public notice provisions of UCC Article 9 are basically found throughout Parts 3 and 4 of the Article).
55. *See id.* § 36-9-302.
56. *See id.* § 36-9-401.

9, section 1-201(37) sets out a much more precise definition of a "security interest."[57] From a reading of both of these sections one can discern that a security interest includes all of the pre-UCC arrangements between vendor and vendee in which the vendor retained an interest in the property conveyed, for example, chattel mortgages and conditional sales contracts. The part of the bailment statute that is applicable to vendor and vendee agreements has therefore been effectively repealed by the adoption of Article 9. Also repealed was the recording statute for mortgages of personal property.[58] The status of the applicability of the bailment statute to leases, however, is not so clear.[59]

Whether a lease is included within UCC Article 9 depends upon whether the lease qualifies as a security interest. Article 9 expressly covers only leases that are intended as security.[60] This limitation implies that all leases not intended as security—true leases—are excluded from the scope of Article 9. The crucial determination, therefore, is the classification of the lease as either a security lease or a true lease. As a preliminary test, the UCC, as enacted by South Carolina, provides that "[u]nless a lease or consignment is intended as security, reservation of title thereun-

57. *"Security interest"* means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (§ 36-2-401) is limited in effect to a reservation of a "security interest." The term also includes an interest of a buyer of accounts, chattel paper or contract rights which is subject to Chapter 9. The special property interest of a buyer of goods on identification of such goods to a contract for sale under § 36-2-401 is not a "security interest," but a buyer may also acquire a "security interest" by complying with Chapter 9. Unless a lease or consignment is intended as security, reservation of title thereunder is not a "security interest" but a consignment is in any event subject to the provisions on consignment sales (§ 36-2-326). Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.

S.C. CODE ANN. § 36-1-201(37).

58. *Id.* § 30-7-10 (1976).

59. As noted earlier in the text (*see* notes 21 and 22 and accompanying text *supra*), bailments comprise a multitude of arrangements of which a lease is just one type. Certainly warehousing, consignments, trust receipts, and the like are all valid bailments, each with a unique status under the UCC-bailment statute dichotomy. It is the intent and scope of this writing, however, to examine the effects of the bailment statute on leases. Consequently, the application of the UCC to leases will be the only inquiry into the remaining validity of agreements between bailor and bailee.

60. UCC § 9-102(2).

der is not a 'security interest' . . . ."[61] As a further guide to the perplexed, the Code explains that:

> Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owners of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.[62]

The resulting uncertainty created by these sketchy guidelines has triggered a great deal of criticism by authors of both textbooks and law review articles.[63] While the crux of the evaluation is whether a security interest was intended by the parties, the tests with which to ascertain this intent are neither complete nor unified.

The UCC supplies one clear test and one guiding inquiry to aid in the evaluation of a purported lease. Under section 1-201(37) if the lease provides for an automatic transfer of the title to the goods for no consideration or only nominal consideration at the termination of the lease period, the lease is one intended for security and is within the purview of Article 9.[64] Should the lease contain an option to purchase upon conclusion of the lease, this option does not of itself make the lease a security lease; however, one can infer from section 1-201(37) that such a provision should be considered in the classification of the lease.[65] These aids offered by the UCC have proved to be inadequate because of the vagueness of such terms as "nominal consideration" and "intended as security."[66] This problem of classifying a lease as a true lease or a security lease has caused consternation in the fields

61. S.C. CODE ANN. § 36-1-201(37) (1976).

62. *Id.*

63. *See, e.g.*, Claxton, *Lease or Security Interest; A Classic Problem of Commercial Law*, 28 MERCER L. REV. 599 (1977); Coogan, *Leases of Equipment and Some Other Unconventional Security Devices: An Analysis of UCC Section 1-207(37) and Article 9*, 1973 DUKE L.J. 909; Hawkland, *The Impact of the Uniform Commercial Code on Equipment Leasing*, 1972 U. ILL. L.F. 446; Peden, *The Treatment of Equipment Leases As Security Agreements Under the Uniform Commercial Code*, 13 WM. & MARY L. REV. 110 (1971); Leary, *Leasing and Other Techniques of Financing Equipment Under the UCC*, 42 TEMPLE L.Q. 217 (1969); Stroh, *Peripheral Security Interests—The Expanded Net of Article 9*, 22 U. MIAMI L. REV. 67 (1967).

64. S.C. CODE ANN. § 36-1-201(37) (1976).

65. *Id.*

66. See authorities cited at note 63 *supra.*

of accounting and taxation as well as in commercial law. Under tax principles, rent payments are deductible as trade or business expenses, but only when the lessee is acquiring neither title to nor an equity in the leased property.[67] Accountants must decide the character of a lease to determine whether to list it as a liability or an asset. To aid in their inquiries, the Commissioner of the Internal Revenue Service and the Accounting Principles Board have issued declarative rulings to aid their practitioners in resolving the security-true lease conflict. Revenue Ruling 55-540[68] of the Commissioner and Opinion No. 5 of the Board[69] each focus to a large degree on whether the terms of the lease cause the lessee to build an equity in the goods, such as when a certain number of payments are required, or when the lessee is required to purchase the goods at the termination of the lease or when the lease term matches the useful life of the goods and the lease payments approximate what purchase payments would be. These tests, however, often prove to be just as fruitless as the guidelines set forth in section 1-201(37). The result is a very unsettled area in commercial law.

This distinction between a security lease and a true lease is of paramount importance to the lessor. If the lease is characterized as one intended for security, then all the requirements, rights, and remedies of Article 9 attach to that lease; if the lease is found to be a true lease, Article 9 does not apply and the lessor is not bound by the UCC. The true lease-security lease distinction also plays a major role in determining whether the South Carolina bailment statute is applicable. Certainly, as with vendor-vendee agreements, when the lease is a security lease within Article 9, the bailment statute is no longer applicable. A true lease, however, since it is not intended as security, falls outside the scope of Article 9 and the bailment statute still applies since only those acts in conflict with the UCC were repealed when South Carolina enacted Article 9.[70] A security lease, therefore, is to be recorded according to the UCC requirements, while a true lease is to be recorded pursuant to the bailment statute.[71] This dichotomy presents the lessor with uncertainty in selecting the proper procedure

67. 26 U.S.C. § 162(a)(3) (1976).

68. 1955-2 CUM. BULL. 41-42, § 4.01.

69. Accounting Principals Board Op. No. 5, 2 CCH ACCOUNTING PRINCIPLES 6523 (1964).

70. *See* note 50 and accompanying text *supra.*

71. For recognition of these observations *see, e.g., In re* Bazen, 425 F. Supp. 1184 (D.S.C. 1977), *aff'd mem.* 471 F.2d 574 (4th Cir. 1978); [1970-71] *Op. Att'y Gen.* 180.

he must follow to protect his interest in the leased property. As noted by the South Carolina Attorney General:

> [w]hen 57-308 [section 27-23-80 (1976)] was last amended in 1962, the Uniform Commercial Code had not been enacted in this State. The words "recorded in the manner provided by law for recording mortgages" had reference to sections 60-101 [section 30-7-101 (1976)] *et seq.*, in effect at that time. Those sections were repealed in 1966 to the extent that they provide for recordation of chattel mortgages. Section 10.10-103, Code of Laws of South Carolina (1962) (vol. 2A, 1966 added vol.) [section 36-10-103 (1976)]. Since January 1, 1968, "the manner provided by law for recording (chattel) mortgages," is the manner provided in Article 9 of the Uniform Commercial Code for perfecting a security interest in chattels.
>
> That change creates somewhat of a delimma [*sic*] in South Carolina because Article 9 specifically excludes a true lease agreement from its provisions [Sec. 10-9.102(2)] [section 36-9-102(2) (1976)] because it does not create a "security interest" [Sec. 10-1.201(37)] [section 36-1-201(37) (1976)]. Consequently, the filing provisions of Article 9 (Sections 10.9-401 through 10.9-407) [sections 36-9-401 through -9-407 (1976] clearly do not contemplate the filing of a financing statement to protect the interest of a lessor.[72]

In attempting to resolve this dilemma, the Attorney General focused on the underlying purposes of the recording requirements of both the UCC and the bailment statute. Both are intended to avoid the secret lien and to protect potential creditors and purchasers from the pitfalls associated with the ostensible ownership of the property by the party in possession. The Attorney General stated in the opinion that this policy of the bailment statute could be effectively continued through the UCC by the filing of financing statements under Article 9 just as if the lease were a chattel mortgage. To protect his proprietary interest, the owner should only note on the financing statement itself that the statement covered a true lease.

In a landmark case, *In re Bazen,*[73] the Federal District Court for South Carolina adopted the South Carolina Attorney General's solution to this anomaly. By complying with the UCC filing procedures the lessor was held to have fulfilled the mandates of the bailment statute. The district court reiterated that "[t]hese

72. [1970-71] *Op. Att'y Gen.* 180, 181.
73. 425 F. Supp. 1184 (D.S.C. 1977), *aff'd mem.*, 471 F.2d 574 (4th Cir. 1978).

acts of filing are in keeping with the purpose of Article 9 and the Bailment Statute to give subsequent purchasers, or creditors, notice of ownership of the personal property which may become the subject of [a] sale or security transaction."[74]

This resolution of the recording dilemmas of the bailment statute establishes that the bailment statute must still be confronted in South Carolina, at least when true leases are concerned. The resolution offered by *In re Bazen,* however, does not eliminate the more intricate predicaments created by the relationship between the UCC and the bailment statute.

III. PROBLEMS UNDER *In re Bazen*

A. Technical filing problems

Both the South Carolina Attorney General and the court in *In re Bazen* indicated that the filing of a financing statement[75] pursuant to Article 9 is the correct way to comply with the bailment statute. The problem with this approach is that it fails to recognize that the UCC does not require the filing of a financing statement to perfect every security interest.[76] Two obvious exceptions to filing that are of importance to the bailment statute are consumer goods and goods subject to a state certificate of title law. Purchase money security interests in consumer goods are completely exempted from filing requirements.[77] Security interests in goods subject to a state certificate of title law, while not subject to UCC filing requirements,[78] are subject to the requirements of certificate of title laws that affect the recording of security interests.[79] The fundamental inquiry, therefore, is whether the court in *In re Bazen,* when incorporating the UCC filing system into the bailment statute, also intended to incorporate the UCC's policies on what situations necessitate a filing and the proper method by which to achieve that filing. In the alternative, did the court intend that the filing of a UCC financing statement was simply to serve as the vehicle with which to fulfill the requirements of the bailment statute? To illustrate this conflict, one example of each type of filing exception will be examined.

74. *Id.* at 1186.

75. For the proper form of a financing statement, see S.C. CODE ANN. § 36-9-402 (1976).

76. *See* S.C. CODE ANN. § 36-9-302 (1976).

77. *Id.* § 36-9-302(1)(d).

78. *Id.* § 36-9-302(3)(b).

79. *Id.* § 36-9-302(4).

In *Ludden & Bates Southern Music House v. Dusenberry*[80] the South Carolina Supreme Court held that the lease of an organ for use in the home for nine months was subject to the bailment statute, and that since the lease had not been filed, the organ was subject to claims of subsequent creditors or purchasers for value without notice of the lease. After *In re Bazen,* the filing of a financing statement pursuant to Article 9 would appear to be the proper way for the lessor to protect his interest in the organ under the bailment statute.[81] Upon turning to the UCC for guidance in the filing of the financing statement, however, the lessor is faced with a serious dilemma. Under section 9-302(1)(d) of the UCC,[82] purchase money security interests in consumer goods are exempt from the ordinary filing requirements. Article 9 defines "consumer goods" as goods "used or bought for use primarily for personal, family or household purposes."[83] The organ in *Ludden* was to be used in the home of the lessee and would easily qualify under the Code as a consumer good. Would the lease be exempt from filing under the Code? That would depend on whether the lease would qualify as a "purchase money security interest."[84] Since it is only the purchase money security interest in consumer goods that is exempted from filing, by implication all other security interests in consumer goods must meet the filing requirements of Article 9. This implication is buttressed by UCC section 9-401(1)(a), which indicates the proper place for filing financing statements for consumer goods.[85] Arguably, a purchase money security interest under the UCC is concerned with advances by the creditor that enable the debtor to acquire the goods. By analogy, a lease of consumer goods is of the same variety of interest because it enables the lessee to acquire the use of the goods.

Under this analysis, if the court in *In re Bazen* intended to

80. 27 S.C. 464, 4 S.E. 60 (1887).

81. For reasons of simplicity and to facilitate the purpose of this illustration, it is assumed that under UCC § 1-201(37) and all applicable tests, the lease involved is a true lease and not one intended as security.

82. S.C. CODE ANN. § 36-9-302(1)(d) (1976).

83. *Id.* § 36-9-109(1).

84. A security interest is a "purchase money security interest" to the extent that it is

(a) taken or retained by the seller of the collateral to secure all or part of its price; or

(b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

Id. § 36-9-107 (1976).

85. *Id.* § 36-9-401(1)(a).

incorporate the UCC provisions that govern the situations in which filing is necessary, the exemption of purchase money security interests from filing would also apply to leases of consumer goods. On the other hand, if the court merely intended to adopt the filing system of the UCC as a vehicle with which to satisfy the bailment statute, the lessor would be required to file a financing statement in the appropriate place.[86]

A corollary to the problem of filing consumer leases arises from the special protection given to purchasers of consumer goods. Section 9-307(2) of the UCC provides that a buyer of a consumer good takes free of even a perfected security interest, provided that he buys the good for value and without knowledge of the security interest, *unless* the secured party has filed a financing statement covering the goods.[87] If UCC policies were incorporated by *In re Bazen,* a lessor who did not file financing statements covering leased consumer goods, while being protected against subsequent creditors by automatic perfection,[88] would not be protected against subsequent purchasers for value without notice. Such an inconsistency would not only be confusing, but would also alter drastically the long-standing protection against claims by subsequent purchaser which the bailment statute affords those who record their lease agreements.[89]

The UCC makes a second exception to its filing requirements when the security interest is in property subject to a state certificate of title statute that provides for either a central filing of the security interest or the indication of the security interest upon the

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86. The proper place to file . . . when the collateral is . . . consumer goods [is] in the office of the register of mesne conveyances or the clerk of court in the county of the debtor's residence or if the debtor is not a resident of this State than in the office of the register of mesne conveyances or the clerk of court in the county where the goods are kept . . . . *Id.* § 36-9-401(1)(a).

87. *Id.* § 36-9-307(2).

88. *Id.* § 36-9-302(1)(a).

89. An even stronger protection is afforded creditors by § 36-9-307(1), which provides that

> [a] buyer in the ordinary course of business (subsection (9) of § 36-1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

S.C. CODE ANN. § 36-9-307(1) (1976). The key requirement in this expansive protection for purchasers of goods is that the purchase must be "in the ordinary course of business." *Id.* As defined at *id.* § 36-1-201(9), this entails only purchasers "from a person engaged in the business of selling goods of that kind." *Id.* § 36-1-201(9). It would be most unusual to find anyone leasing from someone else the very goods that he is in the business of selling. It is doubtful, therefore, that this special protection of § 36-9-307(1) would ever arise in a sale by a lessee.

certificate of title itself.[90] In these situations the secured party must register or file his security interest according to the mandates of the certificate of title statute[91] and the ordinary UCC filing requirements do not apply. South Carolina requires every motor vehicle[92] to have a certificate of title[93] and all security interests in a vehicle to be recorded on that certificate of title.[94] Thus, another dilemma under the bailment statute emerges. Does the lessor of a vehicle subject to state certificate of title laws file a financing statement or does he merely indicate his interest on the certificate of title?

In re Bazen presented the district court with just this sort of certificate of title problem, but the court's opinion did little to clarify the situation. In that case, one of the leased items under attack for noncompliance with the bailment statute was a truck with a concrete mixer attached. The court observed that

> [t]he plaintiff has complied with the UCC filing procedure as required by this construction of the bailment statute: the motor vehicle is titled in the name of the plaintiff as required by § 10.9-302 [section 36-9-302 (1976)] and the financing statements covering the loader and the truck were filed with § 10.9-401 [section 36-9-401 (1976)].[95]

Actually, the plaintiff had not only filed a financing statement with the Secretary of State,[96] but the plaintiff-lessor was also designated as the lien holder on the certificate of title, which listed the plaintiff-lessor as the owner. By endorsing both the filing of the financing statement and the proper listings on the certificate of title, the court's opinion therefore leaves unanswered the question of whether both filing and listing on the title are required for compliance with the bailment statement, or whether only one will be sufficient. Once again, the gravamen of this inquiry revolves around the intent of the court when it incorporated the UCC filing requirements into the bailment statute. If the court intended to incorporate the UCC exceptions and policies concerning filing, lessors would need only to record their

90. *Id.* § 36-9-302(3)(b).
91. *Id.* § 36-9-302(4).
92. Defined in *id.* § 56-19-10(17).
93. *Id.* § 56-19-210.
94. *See id.* § 56-19-610 through -710.
95. *In re* Bazen, 425 F. Supp. 1184, 1186 (D.S.C. 1977).
96. The office of the Secretary of State is the correct place to file a financing statement covering equipment. *See* S.C. CODE ANN. § 36-9-401(1) (1976). For definition of "equipment," see *id.* § 36-9-109(2).

leases in compliance with the certificate of title law.[97] This does not seem appropriate for leases because the lessor is already the titled owner of the vehicle. On the other hand, if the court intended to incorporate merely the method of recording a financing statement, lessors would need only to record financing statements in the appropriate places[98] and indicate on those statements that leases of property are concerned.

The court in *In re Bazen* failed to recognize these intricacies and merely ratified the plaintiff's actions in the case. The dilemma, therefore, still exists: does the bailment statute now simply incorporate the UCC financing statement as merely the vehicle through which one complies with the recordation requirements of the bailment statute, or does it also incorporate the requirements of the UCC filing system, its exceptions, and the idiosyncracies concerning the filing of financing statements?

One approach to a solution of this plight stems from a narrow reading of the two statutes. The bailment statute, as tempered by the UCC,[99] expressly covers every true lease agreement and requires that they be recorded as required by law for the recording of mortgages. The statute then goes on to set out its own list of exceptions to recording.[100] The bailment statute, therefore, defines its own scope and does not need further delineation by or incorporation of the scope provisions of the UCC. Since the UCC now provides the method of recording security interests, including those security interests formerly known as chattel mortgages, a lessor should turn to the UCC to determine how and where to record, and rely on the bailment statute to establish when recording is necessary. Under this interpretation the UCC, along with both the Attorney General's opinion and *In re Bazen,* provides that the method of filing is fulfilled by the financing statement. The place of filing is also prescribed by the UCC and is set out in section 36-9-401 of the South Carolina Code of Laws. This analysis produces the conclusion that all true leases not among the enumerated exceptions are protected under the bailment statute so long as a UCC financing statement is filed in the appropriate office, and that financing statement properly indicates that it covers a lease.

97. *See id.* § 36-9-302(3) - (4), and §§ 56-19-610 to -710.

98. *See note* 96 *supra.*

99. See section II of text.

100. *Viz.*, livery stable keepers, innkeepers, letting or hiring for temporary use or agricultural purposes. S.C. CODE ANN. § 27-23-80 (1976).

An alternative approach is founded on the concept of uniformity of notice. By reference in the bailment statute to the recording of agreements as required by law for recording mortgages, it can be inferred that the intent was to provide the creditor with a uniform place to check or file any interests that are required to be recorded. The creditor must only be familiar with one set of recording requirements and must only examine one set of books to ascertain the true and complete status of the property in question. This uniform system of filing could be achieved in the present day by subjecting the bailment statute completely to the UCC's filing system. A creditor or purchaser would then need to be cognizant of only one set of requirements.

Along with this ease of filing and checking rationale, an additional reason calls for a uniform recording requirement. As mentioned above,[101] the UCC has caused great problems in determining whether a lease should be filed as a security interest under Article 9. With the bailment statute's requirement that all leases be recorded, a uniform filing requirement incorporating the UCC would accomplish both ends: (1) filing would satisfy the bailment statute if the transaction were a true lease; and (2) upon a later finding that the lease was actually a security lease, the lessor would still be protected since his recording complied with the UCC and perfected his security interest. Under the former approach, the potentially separate filing requirements could require double filing by the lessor. Either approach, however, is better than the unresolved dilemma existing today.

B. Theoretical problems

Possible adverse consequences of requiring that UCC financing statements be filed for true leases in this state arise from the plight of a lessor as he debates the issue of whether his lease is one intended as security.[102] Not only are the UCC rights, requirements, and remedies at stake, but, more importantly, accounting and tax benefits of true leases are also affected. The tax benefits of a lease, such as investment tax credits and accelerated depreciation, are enticing to the lessor.[103] Likewise, the accounting ad-

101. See note 63 and accompanying text *supra*.

102. For definition of security interest, see S.C. CODE ANN. § 36-1-201(37) (1976); see also notes 62-66 and accompanying text *supra*.

103. *See*, Coogan, *supra* note 63, at 955 and n.123. *See, e.g.*, T. CUNNANE, TAX ASPECTS OF BUYING AND LEASING BUSINESS PROPERTY AND EQUIPMENT (1974); A. GOLDSTEIN, COMMERCIAL TRANSACTIONS DESK BOOK 121 (1977).

vantages to the lessee concerning capital allocation and the availability of assets for security further support the use of leases when available.[104] Quite often, both the lessee and the lessor desire the transaction to be interpreted as a lease and not as a security interest. The recording of a lease by filing a UCC financing statement causes both parties to run the risk of having this action construed as an indication, if not an admission, that the intent of the transaction is not to create a lease, but a secured transaction.

At least one court, when faced with a filed financing statement by the lessor, decided that such a filing did indicate a security interest. In *In re Lakeshore Transit-Kenosha, Inc.*,[105] the Wisconsin Federal District Court ruled as follows:

> The strongest evidence that the document was intended as a security agreement comes from the acts of the claimant itself. A financing statement was filed in the office of the Secretary of State and the Register of Deeds for Racine County . . . . At the trial the principal witness for claimant, George Dopp, testified that the notice was filed upon the recommendation of the legal department of the B.F. Goodrich Company. This would indicate to the court that the B.F. Goodrich Company intended the agreement to be a security agreement. What other reason would there be for filing it?[106]

If a similar result is reached in determining the nature of a lease filed under South Carolina's bailment statute, a great hardship would be imposed on lessors and lessees within the state, since to comply with the mandates of the bailment statute would destroy the advantages sought by the lease transaction.

The result reached in *In re Lakeshore*, however, should be virtually impossible in South Carolina courts for three reasons. The first and most important reason stems from a closer analysis of *In re Lakeshore* itself. The pivotal aspect of that opinion was a prior decision by the Supreme Court of Wisconsin that no provision existed under Wisconsin law calling for the filing of leases of personal property.[107] Without this requirement, the court felt that the only inference that could be drawn from the lessor's act of filing was that the parties intended to create a securiy interest.

104. *See* Wyatt, *Accounting for Leases*, 1972 U. ILL. L.F. 497. For general information, *see* A. GOLDSTEIN, *supra* note 103, at 20-21.

105. 7 UCC REP. 607 (E.D. Wisc. 1969).

106. *Id.* at 609.

107. *Id.*

In South Carolina, however, the bailment statute requires a recording of leases and *In re Bazen* indicates that a UCC financing statement is the proper method of recordation. No adverse intent should be read into a lessor's act of filing.

The second protection to the lessor derives from a proposed revision to the UCC, presently not enacted in South Carolina. The American Law Institute and the National Conference of Commissioners on Uniform State Laws have proposed a new code section, section 9-408, which will provide for permissive filing of leases. The full text of this code section is as follows:

> A consignor or lessor of goods may file a financing statement using the terms "consignor", "consignee", "lessor", "lessee" or the like instead of terms specified in Section 9-402. The provisions of this Part shall apply as appropriate to such a financing statement but its filing shall not of itself be a factor in determining whether or not the consignment or lease is intended as security (Section 1-201(37)). However, if it is determined for other reasons that the consignment or lease is so intended, a security interest of the consignor or lessor which attaches to the consigned or leased goods is perfected by such filing.

The South Carolina Legislature is still considering all of the 1972 amendments to the UCC and section 9-408 is therefore not yet law in this state.[108] Nevertheless, its principles, rationale, and instructions should carry some weight in interpreting the requirement of filing a financing statement covering a true lease in South Carolina.

The third reason that South Carolina courts will probably avoid the *In re Lakeshore* result rests on a decision of the Georgia Court of Appeals. In *Rollins Communications, Inc. v. Georgia Institute of Real Estate,*[109] UCC section 9-408 had not yet been adopted in that jurisdiction and the lease agreement specifically provided for the filing of a financing statement. The court, in determining the effect of such a requirement, observed that due to the varying, multiple, complex considerations involved in as-

108. At the present time, the 1972 Revisions along with the South Carolina Reporter's comments are in the hands of the Commercial Law Committee of the South Carolina Bar. These revisions should be presented to the legislature within the next year or two. For an analysis of these revisions, see H. Haynsworth, IV Study of the 1972 Revisions to Article 9 of the Uniform Commercial Code (March 1978) (unpublished report for the South Carolina Legislature [hereinafter cited as H. Haynsworth, IV]. As of this writing the 1972 Revisions are still being studied and are not yet in the form of proposed legislation.

109. 140 Ga. App. 448, 231 S.E.2d 397 (1976).

certaining whether a lease is a true lease or one intended for security,

> [i]t is our view that the lessor, faced with such uncertainty, should be permitted to make provisions for precautionary filing without the risk that such provisions would in and of themselves, as urged in the instant appeal, convert the lease into a secured transaction. The review committee for Article 9 proposed in a new § 9-408 that filing is not itself a factor in determining whether a lease is intended as security. [Citation omitted]. We so hold now.[110]

In light of the three foregoing considerations, it seems improbable that any court would consider the filing of a financing statement under the mandates of the South Carolina bailment statute and *In re Bazen* as evidence of intent to create a security interest. No court should penalize a party for the performance of an act required by law.

IV. ALTERNATIVES TO THE BAILMENT STATUTE

With all of the problems elucidated in the foregoing section, it would be wise to examine a few alternatives to the bailment statute as applied to true leases in South Carolina. At the outset, one must recall the motivation behind this statute in order to properly evaluate the proposed alternatives.

The principle underlying the bailment statute is to afford public notice of liens created under the ostensible ownership doctrine and to prevent the lessor from asserting his claim against subsequent creditors if he fails to record his interest in the property. In a lease situation, the possession of the property by the lessee could lead creditors and purchasers of the lessee to believe that he had unencumbered ownership, therefore, inducing an extension of credit or a purchase. To avoid injury to these creditors and purchasers, the bailment statute requires the lessor to provide public notice of the lack of ownership in the lessee by recording the lease agreement.

This principle has recently come under attack. With the advancement of the vast accounting system in today's business world, it is argued that devices such as the financial statement and the balance sheet have replaced the need for recording acts such as the bailment statute:

110. *Id.* at 451, 231 S.E.2d at 399.

> In the face of today's methods of granting credit—financial statement analysis, credit agency report, *et al.*—ostensible ownership appears to be an antiquated doctrine and the presumption that creditors extend credit on the faith of property in the debtor's possession no longer represents the common experience. The Code's drafters should have considered this before blindly incorporating such a dated theory into their "modern" commercial code.[111]

While this observation may accurately portray the general transactions of the business world, it underestimates the use of recording statutes by creditors and purchasers alike. Not only does a recording statute protect against the secret lien, it also provides a quick, convenient place for creditors and purchasers to look for assurance of the debtor's or seller's ownership interests in the property. The requirements of a recording statute carry along with them their own enforcement procedures by eliminating any interests reserved in property that are not recorded. This seems to be far superior to and more appropriate in providing notice of true ownership than would a financial statement prepared by the ostensible owner, because the financial statement is subject to "doctoring" by that ostensible owner.

The main error in this attack on recording acts is that rather than eliminating the ostensible ownership doctrine, the suggested reliance on accounting devices merely substitutes a new means to the same end—protect subsequent creditors and purchasers from the misleading nature of the apparent ownership of the possessor of goods. Rather than turning to the recording act's requirements this new proposal relies on the records of the debtor himself. Certainly this is not much better than asking the debtor if the property is his or not. It seems that this attack on the ostensible ownership doctrine underlying all recording acts carries little weight at all. In today's credit-based economy some form of notice of secret liens is desirable. Recording acts, with their self-enforcing sanctions on nonrecorded interests, are far superior to the use of accounting statements of the parties. That these recording acts are still necessary and accepted today is evidenced by the various bankruptcy statutes and the widespread recent adoption of the UCC and even more recently, the 1972 revisions to the UCC. The recording requirements of the bailment statute

111. Helman, *Ostensible Ownership and the Uniform Commercial Code*, 83 COM. L.J. 25, 32 (1978).

in South Carolina, therefore, remains on sound theoretical underpinnings.

A possible alternative to our bailment statute lies within suggested changes to the UCC. One commentator, William Hawkland, has proposed that rather than retain the security lease-true lease dichotomy, all leases of personal property should be brought within the requirements of UCC Article 9.[112] In deploring the omission of leases from the parameters of the UCC, Mr. Hawkland notes that

> [a]t one stroke, therefore, a new law requiring leases to be filed would solve the lessor's problems with the creditors of the lessee, put purchasers and creditors of the lessee on notice with regard to the ownership of the leased equipment, and enable the lessee to enjoy presently available accounting and tax advantages without his seriously imposing a meaningless no-filing restriction on the lessor.[113]

Other writers in this field have followed Mr. Hawkland's suggestions but have attempted to limit the recording of leases under the UCC to those leases that are "for a substantial term"[114] or that exceed some prescribed term.[115]

Difficulties arise, however, in attempting to place true leases within the confines of Article 9 of the UCC. These problems, as elaborated upon by Peter Coogan,[116] grow out of the very nature of a true lease. Since a true lease is really the sale of the use of property, and in the usual case contemplates the return of the property to the lessor at the conclusion of the lease, the various remedy provisions set out in Part 5 of Article 9 are of little consequence to true leases. The right of the secured party to repossess and sell the collateral[117] is of no help to the lessor as he always remains the true owner of the property. Likewise, the right of the purchaser to redeem the collateral[118] is equally inapplicable to the lessee of a true lease because he has no ownership rights in the property in the first place. These and other provisions of Part 5, just as inappropriate to leases, would provide no remedial benefits for lessees or lessors if all leases were included within Article

112. Hawkland, *The Proposed Amendments to Article 9 of the UCC—Part 5: Consignments and Equipment Leases*, 77 COM. L.J. 108, 114-15 (1972).

113. *Id.* at 114.

114. Leary, *supra* note 63 at 252.

115. Peden, *supra* note 63, at 158.

116. Coogan, *supra* note 63.

117. S.C. CODE ANN. § 36-9-504 (1976).

118. *Id.* § 36-9-506.

9. "If one takes out the heart of the security interest [the remedy provisions], query as to whether the exercise of denominating a security interest is worth the effort?"[119] Mr. Coogan does recognize the need for some form of public notice requirement for leases because of the tendency of a true lease to mislead creditors or purchasers. But, Article 9 with its ineffective remedy provisions does not conveniently incorporate leases within its bounds.

An additional alternative to the bailment statute has been proposed by the South Carolina Reporter for the 1972 Amendments to the UCC.[120] To clear up the various inconsistencies and conflicts between the UCC and the pre-UCC laws in South Carolina, he suggests that the legislature enact a new, specific repealer statute listing sixty-four different code sections that should be repealed or modified. Such a repealer statute would avoid the uncertainty of the general repealer statute enacted in 1966.[121] One of the sixty-four statutes he recommends to be repealed is the bailment statute.[122] In justifying this proposed repeal of the bailment statute, the Reporter relies on the various inconsistencies between the statute and the UCC and the confusion created in attempting to comply with the bailment statute through the UCC and *In re Bazen.*[123] An additional justification for this repeal would lie in the goal of cohesiveness and uniformity within the UCC. The bailment statute of South Carolina serves as a trap for unwary out-of-state lessors since this statute extends also to leases executed outside of this state.[124] Because leases do not properly fit within the Code, an inclusion to the contrary would only destroy that goal.

IV. Conclusion

The leasing of personal property has expanded into a major commercial transaction within the last few years. For this reason the lease needs to be subjected to various requirements in order to ensure that it does not become a widely abused transaction. Certainly the most dangerous aspect of a lease is its ability to mislead creditors or purchasers into relying on the apparent own-

119. Coogan, *supra* note 63, at 960.

120. See H. Haynsworth, IV, *supra* note 108, at 283-87.

121. S.C. Code Ann. § 36-10-103 (1976).

122. H. Haynsworth, IV *supra* note 108, at 283-87 (the bailment statute is number 51 in the list of statutes he proposes to be repealed).

123. *See id.* at 287-90, 307-08 (S.C. Reporter's notes).

124. Sheldon v. Blauvelt, 29 S.C. 453, 7 S.E. 593 (1888). *See* Ludden & Bates Southern Music House v. Dusenberry, 27 S.C. 464, 4 S.E. 60 (1887).

ership of the lessee in possession of the property. It was this deceptive nature of a lease that motivated the legislature to include leases within the recording statutes of South Carolina. The misleading character of secret liens is a major consideration of the drafters of Article Nine, which has been adopted by forty-nine of the fifty states. For it is the secret lien that the notice filing requirements of Article 9 are aimed at eliminating. The lease is no less misleading than the security interest. If anything, it is more misleading because in the security interest the debtor has some interest or equity in the goods. In the lease, the lessee has no interest or equity in the goods.

The bailment statute, though severely limited by the UCC, still applies to true leases in this state since the UCC excludes true leases from its coverage. Although technical problems do cause difficulties in the administration of the bailment statute, all that is needed is a legislative explanation of the proper procedure for complying with the statute's mandates. By redrafting the bailment statute, the legislature could retain the vehicle for effecting the recognized desirability of public notice of the lease, update the bailment statute's coverage by limiting its scope to those areas not already preempted by the UCC, and provide for the proper procedures for meeting its requirements.

This retention of a modified or updated bailment statute is preferrable to those available alternatives. To repeal the bailment statute would be a violation of the established need for public notice of leases or personal property. To incorporate all leases within Article 9 of the UCC, on the other hand, would seem to be overkill. Since the remedy provisions of Article 9 do not apply to the lease situation, there seems no reason to include leases within the UCC itself. Rather, it is the public notice established, under a modified bailment statute by recording leases in keeping with the appropriate UCC filing procedures that provides the clearest, easiest, and most adequate method of complying with the present day necessities of the commercial world.

By way of illustration, the new bailment statute could read as follows:

> (1) All leases, bailments[125] and any other agreement between the bailor and bailee of personal property for a longer period than six months (either by its express terms or through

125. Bailments are left within the purview of this proposed statute since the effect of Article 9 on those agreements is not within the scope of this note and remains to be explored.

the exercise of a renewal option clause)[126] whereby the bailor shall reserve to himself any interest in the property shall be null and void as to subsequent creditors (whether lien creditors or simple contract creditors) or purchasers for a valuable consideration without notice *unless* a financing statement properly indicating the type of agreement involved is filed with the appropriate office as listed in § 36-9-401 for the perfection of a security interest in that property.

(2) But nothing herein contained shall apply to livery stable keepers, innkeepers, property used for agricultural purposes, property deposited for purposes of repair of work or labor done thereon, or as a pledge or collateral to a loan.

(3) For purposes of this act, the "*financing statement*" shall comply with the requirements of § 36-9-402.

This proposed statute adequately protects against the evils of the secret lien by providing all potential creditors or purchasers with notice of the true status of the property. By expressly utilizing the UCC financing statement and requiring filing with the appropriate office under Article 9, three needs are served: first, the technical *In re Bazen* problems of the present statute are solved; second, both the potential creditor and the lessor himself are provided with a central filing place for both Article 9 security interests and leases under this new bailment statute; third, the lessor, by filing, not only protects his lease under the bailment statute, but these procedures also protect him should his lease be ruled a security lease, because his original filing would comport with Article 9 standards. Finally, by delineating a six-month test to determine what leases to record, the vaguesness of the present statute is eliminated. A workable bailment statute that requires the recording of leases of personal property would be a great contribution to commercial law.

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126. The six-month time limit is aimed at excluding trivial leases, such as the hourly or daily rental of tools and other equipment, from the rigors of a recording requirement. Although other tests to exclude trivial leases exist, such as a dollar amount test, the length-of-time test seems to be the easiest, most accurate and most effective test.